



THE ROSE CORPORATION

Building Partnerships





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About the Cover

In 1998, through a joint venture with Rospin Corporation, the Company was proud to purchase a 50% interest in Toronto's landmark Flatiron Building.



The Rose Corporation provides strategic capital to both short and longer-term real estate investment opportunities. The short-term structured financing side of the Company's business generally takes the form of secured mezzanine or participating loans. The longer-term strategic investment side of the business involves the acquisition of real estate assets connected with certain core operating businesses such as self-storage mini-warehouse operations, assisted living adult care centres, and commercial rental properties.



Letter to Shareholders

DEAR SHAREHOLDERS,

In keeping with the direction set in last year's Letter to Shareholders, we have pursued a real estate investment strategy that draws on the knowledge and experience gained during our history in the development and construction business. Within the field of real estate investment, The Rose Corporation now occupies a unique position and has become a significant participant within its market niche.

Our business has been divided into short and longer-term segments for reporting purposes. The short-term structured financing segment of the business has flourished over the past twelve months and is expected to continue, notwithstanding a general economic softening. Major institutional lenders to the development sector are looking for increased levels of cash equity or guarantees for their loans, which leads to new opportunities for the Company. Our longer-term strategic investments have also grown significantly over the year. Particularly in the areas of assisted living, self-storage, and the rehabilitation and repositioning of historical commercial properties, we have been pleased with the pace and quality of acquisitions. With our purchase of the Toronto Film Studio, we also appear to have happily hit a home run. Finally, our resort hotel in Huntsville continues to produce stable earnings far disproportionate to its current written down book value.

Perhaps even more than the growth and quality of our portfolio, we are pleased with the development of our management team. Over the year, we have come to appreciate the wealth of development, construction, legal, accounting, tax, banking, and transactional experience that we are able to put at the disposal of our investment partners. More important, they appreciate it, and we believe that this gives us a distinct advantage over our competition and accounts for the unique position we enjoy within our industry.

The theme of this year's Annual Report is captured in the phrase "Building Partnerships". While something of a play on words given the development orientation of all of our current activity, it is much more a testament to the real thrust of the past year's activities and our focus for the future. Although each investment is structured around its own facts and circumstances, what is common to almost all of our transactions is the relationship we have to outside management groups. Our involvement with these strategic partners is allowing us to harness capabilities and entrepreneurial talent otherwise well beyond the reach of a company our size and, over time, to build relationships on a mutual foundation of trust, understanding, and respect.

The specifics of this past year's transactions are set out in greater detail in the Business Review and Management's Discussion and Analysis sections of this report. It will be apparent that it has been a productive year in terms of business development. Especially within the short-term financing segment, very few transactions within our niche occur in the local market without our having an opportunity to consider financing them. Despite its transaction orientation, we believe that we are well on our way to developing this segment of the business into a very profitable enterprise, able to deliver quality earnings

on a recurring basis. Similarly, within each of the areas of longer-term strategic investment, we are developing a lower but nonetheless respectable profile within those industry segments.

This year also saw the establishment of a \$20 million credit facility with Fortress Investment Corp. This line is available to finance investments in both portfolios and, in the case of properties owned by the Company, will subordinate to ordinary first mortgage financing. This facility is intended as a short-term measure to bridge the Company to a point where it can raise capital in the traditional equity or



debt markets. In that regard, the past year has been frustrating as publicly traded real estate companies and REITs have fallen out of favour with investors. We are making efforts to raise our profile in those markets in anticipation of an eventual return of liquidity and are, meantime, exploring a variety of financing initiatives.

This year's results do not fully reflect the success we have had with our new business direction. Reported earnings have been impacted on by losses from discontinued operations, including the sale of the last of our

U.S. enterprises, Hayden Industrial Products. Coupled with the fact that the new business direction has ramped up gradually over the year, even an adjustment for these events would not reflect what might be expected from annualized operations at the current level, ignoring further growth potential and the inherent but unrecognized gains attributed to many of our longer-term strategic assets. All in all, we are very pleased with our progress so far.

Two other events warrant brief mention. As you have already noticed, following the approval at last year's Annual and Special Meeting of Shareholders, our name change was implemented shortly before the end of fiscal 1998. As you will soon notice, following the disposition of our last U.S. business, we have reverted to Canadian dollar reporting.

In closing, we look forward to a year of growth and profitability. We are convinced that if we maintain our focus and direction, the public markets will eventually reward our stockholders with a share value that more truly reflects the Company's inherent worth.

Yours very truly,

Sam Reisman
Chairman and Chief Executive Officer

Stephen R. Morrison
President

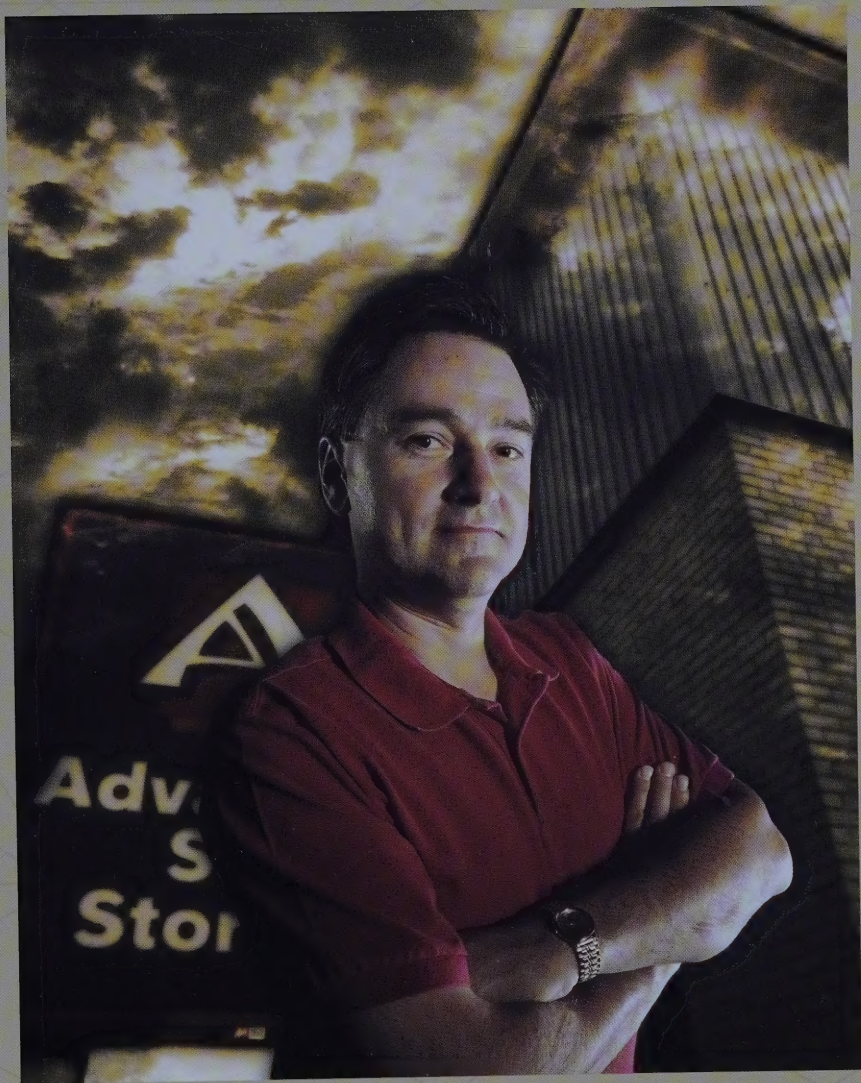
Real trust involves more than simple faith in another's integrity. Beyond honesty, it demands confidence that the other's commitment is fundamental to their character. In our relationship with Jeffrey Kinder and Advantage Self-Storage Limited, we have established the kind of two-way trust that is at the core of successful partnership.

BUSINESS REVIEW

Overview Operating, in most cases, through outside developers and management groups, The Rose Corporation provides strategic capital to both short and longer-term real estate investment opportunities. With the sale of Hayden Industrial Products in April 1998, the Company is now focused solely on this core business.

Short-Term Structured Financing The short-term structured financing side of the Company's business generally takes the form of secured mezzanine loans with terms of between twelve and thirty months. Most often, the return to the Company takes the form of a lump-sum fee and an interest charge. While a portion of the interest rate is often paid on a monthly basis, it is typical for most of the fee and interest to be deferred to near the completion of the project. For accounting purposes, revenues are accrued based on the expected internal rate of return for the planned duration of the loan, after provision for a reasonable allowance. In some instances, the Company will also receive a percentage of the project profits and, in those cases, may hold an interest in the project through a limited partnership or joint venture structure. These earnings are recognized only when profits are actually realized.

The Company's customers are typically experienced real estate developers in need of equity or near equity loans to enable them to source traditional construction and take-out financing. In looking at any given opportunity, management engages in a detailed risk assessment which includes an evaluation of the strength and experience of the developer, the equity contributed, the expected project cash flows and profitability, the extent of pre-sales or pre-leasing, where applicable, a third party review of the project and construction budgets, a market review, and verification of zoning and other municipal matters. As at July 31, 1998, there were eleven loans outstanding, totalling \$21.8 million. By the end of the first quarter of fiscal 1999, that total had increased to about \$29 million.



Partners must understand each other's strengths and weaknesses at a very visceral level. Only through deep understanding can realistic expectations be set and achieved. Through the two investments we made this year with Triloft Developments Ltd., we have come to understand the competencies and capabilities with which we are each able to add value to a project.

To date, most transactions have been in southern Ontario, but the Company continues to explore other markets. Approximately 75% of the transactions in this segment of the Company's business involve residential properties, mostly condominium high rise lofts and townhomes. The remaining 25% involve commercial properties, primarily strip plazas or power retail centres.

Longer-Term Strategic Investments The longer-term strategic investment side of the business, classified as Income Producing Assets in the financial statements, involves the acquisition of real estate assets connected with certain core operating businesses. Those businesses, to date, include self-storage mini-warehouse operations, assisted living adult care centres, commercial rental properties, a large film studio, and a resort hotel. In each case, the Company has supplied most or all of the capital to acquire the assets. With the exception of the film studio, common to each of these investments is the fact that we have aligned with entrepreneurial managers, each of whom has a demonstrated ability to manage and develop properties within their respective niches, and who will, through their own companies, enjoy participation in the cash flow and value growth of the assets, after a return of the Company's invested capital together with a preferred return.

Self-Storage Mini-Warehouse Properties During fiscal 1998, the Company acquired three self-storage mini-warehouse properties, all in Ontario. Two were existing operating facilities, and the third was a vacant industrial building. The two operating units are located in Barrie and Nepean (near Ottawa), and comprise about 109,000 leaseable square feet. Both are profitable and achieving between 85 and 90% occupancy levels.



Building Respect

While relationships may be based on trust and understanding, the real reward in building a successful partnership is the respect that the parties come to have for each other over time. Although our involvement with Rospin Corporation is not of long standing, we are gratified by the mutual respect that has been engendered in such a short time.

The vacant building, located in Hamilton, Ontario, consists of approximately 32,000 leaseable square feet. Since year end, renovations have been completed and the first lease was signed in late August. A fourth facility of about 39,000 leaseable square feet, also requiring conversion, was acquired after year end. Renovations are underway and are expected to be completed early next calendar year. It is expected that each of these converted facilities will take about two years to reach normal operating capacity.

The properties are all managed by Advantage Self Storage Limited, a company owned 50% by the Company and 50% by Jeffrey Kinder. Mr. Kinder, for many years a senior employee of the Public Storage group of companies, has a career-long history in the self-storage industry.

Assisted Living Care Centres Assisted living adult care refers to the unregulated provision of residential and auxiliary services, such as meals, cleaning, and laundry to the senior segment of the population. Typically, individuals can select from several levels of service as their personal circumstances dictate, and increase those service levels over time. This mode of living is becoming an increasingly popular alternative to the registered nursing home for those whose circumstances do not require a higher level of medical supervision and assistance.

Two properties have been acquired to date: a 201-unit apartment building, and a 157-room hotel, both in Ottawa, Ontario. It is intended to convert both to assisted living centres. Renovations to the apartment building were commenced in October 1998 and are expected to be completed by the end of this calendar year. The hotel, when acquired, was operating under a Super 8 flag, but has subsequently been repositioned as a Ramada Inn. It is operating satisfactorily and generating modest earnings pending its conversion in early calendar year 1999. A total of 98 suites will ultimately be available for assisted living. It will take about three years for each facility to reach effective full occupancy. Our investments in this area are managed under contract by the Senior Living Group, a company controlled by Josef Ger.



Commercial Rental Properties The Company has recently entered into a joint venture arrangement with Rospin Corporation to purchase, refurbish, and upgrade certain historical office and commercial properties in Metropolitan Toronto. Two such properties, totalling approximately 33,000 leaseable square feet, were acquired during this fiscal year. One of them, the well-known Flatiron building in downtown Toronto, was acquired to the extent of 50% with the balance expected to be purchased early in calendar year 1999. Both properties are fully leased and will continue to operate while undergoing renovations, mostly to their exteriors. The buildings will then be repositioned over a two to three year period as leases expire. A third building of the same nature comprising 19,000 leaseable square feet was purchased after year end with closing expected in November 1998.

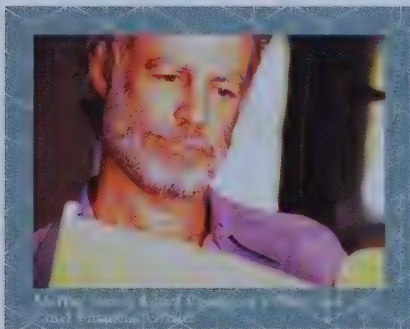
Rospin Corporation, a company controlled by Paul Rosen and Michael Tippin, is managing all of these properties and, through a related company, will enjoy a 50% interest in any return from these properties after the Company has recovered its capital and a preferred return. It is expected that each building will be refinanced within three years to an extent that will allow the return of all or most of the Company's equity investment.

Film Studio In January 1998, the Company acquired a facility now renamed the Toronto Film Studio in downtown Toronto. Comprising a total of approximately 235,000 square feet of sound stages, construction shops, production support services, and office space, it is one of the largest such facilities in Canada and is under constant demand. A single tenant under a two-year lease currently occupies approximately 50% of the available space. It is fully owned by the Company and managed internally.

Hotel In the late 1980s, the Company acquired the Best Western Hidden Valley Resort Hotel in Huntsville, Ontario. A 100-room lakeside facility, the hotel operates on a year-round basis. Despite being carried on our balance sheet at approximately \$1.4 million, based on current performance, a recent appraisal shows an indicated value of more than \$6 million. For the past seven years, the property has been managed by D.E.I. Management Inc., a company controlled by David Elkayam.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview In 1995, the Company's U.S. subsidiary, The Equion Corporation, began the process of selling its business units. Pursuant to this process, the Company sold its Signet Systems division together with its Signet AutoAir subsidiary in July 1995, the TCI division in December 1995, the Trans-Tool division in February 1996, the Hayden division's engine driveline product line in April 1996, and Hayden's aftermarket cooling business in December 1996. On April 30, 1998, the Company sold Hayden Industrial



Products, its last investment in the automotive and industrial sector, to the Company's principal shareholder group. The results of the operations for the year and the gain on the sale of the division have been accounted for as discontinued operations, as set out in note 3 to the financial statements.

With the sale of the last automotive and industrial division, the Company changed its name to The Rose Corporation to reflect its return to the active real estate investment business. The Company's short-term

structured financing side of its business includes mezzanine loans, guarantees, and direct equity participation. These high-yield investments provide a profitable earnings base and, more importantly, help build relationships and create opportunities for the longer-term investment side of the Company's business. This involves investment in certain specialized, niche, income producing and growth real estate assets. During fiscal 1998, the Company acquired an apartment and hotel which will be converted to assisted living adult care centres, three self-storage mini-warehouse facilities, a film studio, and two commercial rental properties.

The Company had operating earnings of \$1.6 million in 1998 on its real estate investments, net of minority interest (\$0.2 million last year), notwithstanding that most of the income producing properties were acquired late in the year and therefore contributed only nominal earnings.

To date, all the Company's real estate investments have been made in the Province of Ontario. The Ontario real estate market is currently active, with many opportunities to provide financing in the commercial and residential markets and to expand the Company's investment in income producing properties. As part of its investment strategy, the Company also considers opportunities in other jurisdictions.

In 1998, with the sale of the last U.S. holdings, the Company has returned to Canadian dollar reporting. The Company has also changed its reporting in compliance with Canadian and U.S. accounting practices for real estate and financing companies. As a result, the balance sheet is no longer classifying current assets and liabilities. The Company's audited consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles (see note 15 to the financial statements for a reconciliation to U.S. generally accepted accounting principles).

Financial Condition, Liquidity, and Capital Resources The Company has \$14.3 million of mortgages payable (nil – 1997) on income producing properties. Approximately \$3.4 million of the principal is due to be repaid in fiscal 1999, most of which has been or is expected to be renewed or refinanced. The Company also has a loan payable of \$2.0 million at July 31, 1998 (\$10.0 million at



October 15, 1998), drawn against its \$20.0 million credit facility with Fortress Investment Corp. The credit facility was entered into on May 15, 1998, for a one-year term expiring July 20, 1999, and may be extended at the Company's option for up to one additional year.

In May 1997, the Company initiated a normal course issuer bid through the facilities of The Toronto Stock Exchange. Pursuant to this bid, the Company purchased 84,100 common shares at an average price of \$1.19 before the bid expired on May 8, 1998.

The Company has committed to fund an additional \$3.5 million in respect of the \$15.2 million of loans receivable as at July 31, 1998. In addition, \$5.0 million of new loans have been committed subsequent to year end. As at July 31, 1998, through its joint venture (see note 14(b) to the financial statements), the Company had acquired a 25% interest in a rental property in downtown Toronto, and had agreed to acquire another 25%. The Company had also committed to acquire an additional self-storage site. Since year end, the Company has agreed to acquire a 50% interest in another self storage site and a commercial rental building. The Company's share of the purchase price for these additional commitments will be \$4.3 million. The total expected funding required by the Company after year end for all of its income producing properties to date, including future improvements, is approximately \$16.0 million, about one-half of which is anticipated to be funded by third-party financing.

Cash and short-term investments decreased to \$1.9 million as at July 31, 1998, \$14.1 million lower than at July 31, 1997. The decrease is substantially attributable to investments in structured financing loans and income producing properties, net of proceeds from the sale of Hayden Industrial Products. Restricted cash is \$1.1 million, up \$0.4 million from July 31, 1997. The Company believes that its unrestricted cash position, operating cash flows, scheduled loan repayments, anticipated mortgages on income producing properties, and its credit facility are sufficient to meet all known cash commitments. Additional cash resources will be required as the Company expands its real estate investment business. In that respect, the Company continues to explore financing options.

Year 2000 Compliance The Company set up a Year 2000 project team in late 1997 to assess its information systems and embedded technology operational systems. The assessment included internal business and financial systems, technical infrastructure, and systems within the Company's income

producing properties such as: property management systems, point-of-sale systems (for food and beverage outlets), elevators, telephones, heating and air-conditioning systems, and security and fire alarm systems. These systems were prioritized according to business impact and risk factors, and a plan was devised for appropriate remedial action.

The Company's systems are primarily acquired from third parties, and suppliers have been contacted to ensure that existing Year 2000 compliance issues have been identified and appropriate remedial action is being taken. The project team's assessment of the Year 2000 issue is ongoing, and the Company expects that all of its critical systems will be fully Year 2000 compliant by mid 1999.

Costs incurred to date in connection with the Year 2000 compliance issue have been immaterial, and the Company does not expect the future costs of remedial measures to have a material impact on its results of operations, liquidity, or capital resources.

RESULTS OF OPERATIONS

1998 versus 1997

Summary Revenues for 1998 were \$9.6 million, versus \$10.4 million last year. Revenues in 1997 were higher primarily due to the sale of the Whitby project. Operating earnings of \$1.5 million were recorded this year, compared with \$0.2 million last year. Net of minority interest, income taxes, and discontinued operations, the Company reported earnings of \$1.1 million in 1998, versus a loss of \$1.3 million in 1997.



Automotive and Industrial (discontinued operations – see note 3 to the financial statements) On April 30, 1998, the Company sold its last automotive and industrial business to the Company's principal shareholder group for \$7.4 million (U.S.) plus the assumption of certain liabilities. The sale generated an after tax gain of \$1.7 million. Losses carried forward from prior years reduced the taxes otherwise payable on the gain. The gain was offset by \$0.4 million of charges relating to sales of previous automotive and industrial businesses, and by \$1.7 million of net operating losses.

Financing and Development Earnings of \$2.9 million were recorded during the year on 11 loans receivable, net of allowances of \$0.5 million. The loans range in amounts between \$0.3 million and \$3.7 million. The loans earn fees and interest, and are yielding an average of approximately 30% per annum before allowances, including the portion of the interest and fees which is deferred and collected when the loan principal is repaid. The Company recognizes this revenue based on the return expected over the term of the loan. To the extent that the Company also participates in project profits, this portion is recorded only when realized.

In 1997, revenues and earnings of \$0.3 million were recorded on four loans receivable. In addition, the Company sold its last Symphony Place condominium suite and its Whitby site for net proceeds of \$6.1 million, resulting in earnings of \$0.4 million net of carrying costs for the Whitby site prior to its sale. Offsetting these earnings, a \$0.7 million charge was recorded to reflect an unfavourable decision in connection with the Hidden Valley condominium litigation matter.

Income Producing - Hospitality Revenues for the Best Western Hidden Valley Resort Hotel for the year were \$2.8 million, unchanged from last year. Higher average room rates have offset lower occupancy levels. Earnings increased from \$0.54 million last year to \$0.6 million this year, primarily as a result of a more favourable revenue mix.

During 1998, the Company invested in two properties located in Ottawa, Ontario, which will be converted to assisted living adult care facilities. The Company has a 30% minority shareholder in the properties.

One of the properties is a 201 unit apartment building that is undergoing renovation. All costs associated



with this property are being capitalized until the occupancy level builds to about 65%, expected by the end of fiscal 1999. The other property is currently being operated as a 157 room Ramada Inn. It will also undergo renovation, although not on the same scale. This property was acquired late in the year, contributing \$0.8 million of revenues and \$0.1 million of earnings, net of minority interest. The conversions are both expected to be completed by July 31, 1999.

Income Producing - Rental Properties Revenues for the year were \$2.1 million. Earnings of \$0.2 million were generated, net of minority interest. A total of \$14.1 million has been invested since the beginning of the year in three self-storage facilities, a film studio, and two commercial properties.

The Company has a 20% minority shareholder in the self-storage facilities. The properties are located in Barrie, Nepean (near Ottawa), and Hamilton, Ontario and are being operated by a management company in which the Company has a 50% interest. The Hamilton site was a vacant industrial building when acquired. Renovations were completed and the first lease was signed in August 1998. The earnings realized by the operating companies were offset by losses from the management company.

The film studio was acquired mid year and has been performing better than anticipated. It generated most of the earnings in this sector. The studio is one of the largest in Canada and is undergoing significant renovations. These capital improvements continue to generate higher rental revenues.

The two commercial properties are co-owned with a 50% co-venturer and were acquired in the fourth quarter. Although they had nominal earnings for the year, both properties are performing on budget.

Both are historical Toronto buildings and renovations are planned for the coming year. The Company anticipates that higher rental rates will be achieved once these renovations are complete.

Corporate and Other Net corporate overheads were \$2.2 million for the year, versus \$0.4 million last year. The increase primarily reflects lower interest income earned on surplus corporate funds that have been used in the Company's real estate investment business, together with increased costs in support of that business.

RESULTS OF OPERATIONS

1997 versus 1996

Summary Revenues for 1997 were \$10.4 million, versus \$6.8 million in 1996. The increase is primarily attributable to the sale of the Whitby project. Operating earnings of \$0.2 million were recorded in 1997, compared with a loss of \$4.6 million in 1996. Net of income taxes and discontinued operations, the Company reported a loss of \$1.3 million in 1997 and \$5.7 million in 1996.

Financing and Development Revenues and net earnings of \$0.3 million were recorded on four loans yielding, on average, about 30% per annum. The loans originated during the fourth quarter of 1997 and were all due within the next two years.

During the year, the Company sold its last Symphony Place condominium suite and its Whitby site for net proceeds of \$6.1 million, resulting in earnings of \$0.4 million net of carrying costs for the Whitby site prior to its sale. Offsetting these earnings, a \$0.7 million charge was recorded to reflect an unfavourable decision in connection with the Hidden Valley condominium litigation matter.

In 1996, revenues of \$2.4 million and earnings of \$0.1 million were generated primarily by the sale of the Markham land development site and two Symphony Place condominium suites. A \$4.4 million provision for diminution in asset value was recorded in connection with the Whitby property, resulting in a \$4.2 million net loss.

Income Producing – Hospitality The Best Western Hidden Valley Resort Hotel recorded revenues of \$2.8 million and earnings of \$0.54 million in 1997, an increase of 7% and 132%, respectively, over 1996 revenues of \$2.6 million and earnings of \$0.23 million. The revenue increase reflects higher occupancies and room rates. As a result of the stability of the property, the higher revenues produced, for the most part, dollar-for-dollar higher earnings. Together with other savings and efficiencies, year-over-year earnings more than doubled.

Corporate and Other Net corporate overheads and other outlays of \$0.4 million were incurred in 1997, versus \$0.6 million in 1996. The difference is primarily attributable to the elimination of dividends and interest on the preferred shares and long-term debt that were repaid during fiscal 1996.

Auditor's Report

TO THE SHAREHOLDERS OF THE ROSE CORPORATION

We have audited the consolidated balance sheets of The Rose Corporation as at July 31, 1998 and 1997 and the consolidated statements of earnings, retained earnings and cash flows for each of the years in the three year period ended July 31, 1998. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at July 31, 1998 and 1997 and the results of its operations and its cash flows for each of the years in the three year period ended July 31, 1998 in accordance with generally accepted accounting principles.

KPMG LLP

Chartered Accountants

Toronto, Canada

October 15, 1998

Consolidated Balance Sheet

(Expressed in Canadian thousands of dollars) (note 2)

	July 31	
	1998	1997
Assets		Restated (note 1)
Cash and short-term investments (note 16(a))	\$ 1,930	\$ 16,021
Restricted cash (note 16(b))	1,080	683
Loans receivable (notes 4 and 5)	15,192	7,416
Investments in and loans to limited partnerships (note 14(a))	6,656	—
Trade receivables, less allowance of \$7 (\$367 - 1997)	322	2,875
Amounts receivable (note 6)	176	3,829
Prepaid expenses and other assets	1,553	930
Deposits	1,228	—
Advances to or from related companies (note 8(f))	620	(26)
Capital assets (note 9)	27,625	4,187
Goodwill	—	1,728
Deferred income taxes (note 12(b))	—	413
Inventories (note 7)	—	1,679
	\$ 56,382	\$ 39,735
Liabilities		
Accounts payable and accrued liabilities	\$ 3,125	\$ 4,585
Mortgages and loan payable (note 10)	16,306	—
Taxes payable	216	—
Customer deposits	467	70
Other liabilities	876	798
	20,990	5,453
Minority Interest	19	—
Shareholders' Equity (note 11)		
Common shares		
Authorized: unlimited		
Issued and outstanding: 22,863,796 - (22,875,900 - 1997)	33,027	33,043
Cumulative translation adjustment	(100)	(61)
Retained earnings	2,446	1,300
	35,373	34,282
	\$ 56,382	\$ 39,735

Commitments and contingencies (note 19)

(See accompanying notes)

APPROVED BY THE BOARD



Sam Reisman
Director



Stephen R. Morrison
Director

Consolidated Statement of Earnings

(Expressed in Canadian thousands of dollars except per common share amounts) (note 2)

	Year ended July 31		
	1998	1997	1996
Revenues			
Revenues from income producing properties	\$ 5,799	\$ 2,786	\$ 2,609
Interest and fee income	3,441	1,487	1,813
Interest from limited partnerships (note 14(a))	342	—	—
Property sales	—	6,110	2,341
	9,582	10,383	6,763
Operating expenses			
Operating expenses	3,280	6,426	3,394
Selling, general, and administrative	3,864	3,508	2,435
Interest expense	448	—	294
Depreciation and amortization	527	227	317
Provision for diminution in asset values (note 14(b))	—	—	4,362
Dividends paid on preferred shares	—	—	568
	8,119	10,161	11,370
Earnings (loss) from operations	1,463	222	(4,607)
Income taxes - current (note 12)	46	29	19
Earnings (loss) before minority interest	1,417	193	(4,626)
Minority interest in losses of subsidiaries	(129)	—	—
Earnings (loss) from continuing operations	1,546	193	(4,626)
Loss from discontinued operations (note 3)	(402)	(1,450)	(1,108)
Net earnings (loss)	\$ 1,144	\$ (1,257)	\$ (5,734)
Net earnings (loss) per common share (note 13)			
Basic and fully diluted:			
Continuing operations	\$ 0.07	\$ 0.01	\$ (0.20)
Discontinued operations	\$ (0.02)	\$ (0.06)	\$ (0.05)

(See accompanying notes)

Consolidated Statement of Retained Earnings

(Expressed in Canadian thousands of dollars) (note 2)

	Year ended July 31		
	1998	1997	1996
Balance - beginning of year	\$ 1,300	\$ 2,547	\$ 8,387
Net earnings (loss)	1,144	(1,257)	(5,734)
Discount on repurchase of common shares	2	10	—
Premium on redemption of preferred shares	—	—	(106)
Balance - end of year	\$ 2,446	\$ 1,300	\$ 2,547

(See accompanying notes)

Consolidated Statement of Cash Flows

(Expressed in Canadian thousands of dollars) (note 2)

	Year ended July 31		
	1998	1997	1996
		Restated (note 1)	Restated (note 1)
Operating activities			
Net earnings (loss)	\$ 1,144	\$ (1,257)	\$ (5,734)
Adjustments to reconcile net earnings (loss) to net cash flow from (used in) continuing operations:			
Loss from discontinued operations (note 3(a))	402	1,450	1,108
Depreciation and amortization	527	227	317
Minority interest in losses of subsidiaries	(129)	-	-
Provision for diminution in asset values	-	-	4,362
	1,944	420	53
Changes in non-cash operating balances (note 18(a))	(1,507)	4,576	984
Cash flow from continuing operations	437	4,996	1,037
Cash flow from (used in) discontinued operations	(2,763)	3,427	(4,407)
Cash flow from (used in) operating activities	(2,326)	8,423	(3,370)
Financing activities			
Mortgages and loan payable	4,424	(2,940)	(5,461)
Repurchase of common shares	(16)	(125)	(569)
Financing activities from discontinued operations	-	243	(306)
Redemption of preferred shares (note 8(c))	-	-	(6,854)
Cash flow from (used in) financing activities	4,408	(2,822)	(13,190)
Investing activities			
Loans receivable	(7,776)	(7,476)	-
Investments in and loans to limited partnerships	(6,656)	-	-
Proceeds on disposal of discontinued operations	14,456	5,181	35,323
Purchase of capital assets	(12,627)	(76)	(85)
Capital expenditures of discontinued operations	(1,233)	(1,290)	(797)
Restricted cash	(397)	57	-
Cost of acquisitions, net of cash (notes 3(b) and 3(e))	(2,000)	-	(17,582)
Cash flow from (used in) investing activities	(16,233)	(3,604)	16,859
Effect of exchange rate changes	60	(203)	19
Increase (decrease) in cash and cash equivalents	(14,091)	1,794	318
Cash and cash equivalents - beginning of year	16,021	14,227	13,909
Cash and cash equivalents - end of year (note 16(a))	\$ 1,930	\$ 16,021	\$ 14,227

(See accompanying notes)

Notes to Consolidated Financial Statements .

(Tabular amounts expressed in Canadian thousands of dollars, except per common share amounts)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements of the Company are prepared in accordance with accounting principles generally accepted in Canada and guidelines set out by the Canadian Institute of Public Real Estate Companies, which conform in all material respects with accounting principles generally accepted in the United States, except as indicated in note 15.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its subsidiaries, together with the Company's proportionate share of the assets, liabilities, revenues and expenses in joint ventures. All material intercompany accounts and transactions have been eliminated.

Investments in Limited Partnerships

Investments in limited partnerships are accounted for by the equity method.

Basis of Presentation

In recognition of substantially all current revenues originating in Canada through investments and subsidiaries, the Company reports its results in Canadian dollars. Any monetary assets and liabilities denominated in U.S. dollars are translated into Canadian dollars using the end of period exchange rate for assets and liabilities and an average prevailing rate during the period for revenues and expenses. Any resulting translation gain or loss is recorded in the consolidated statement of operations in the period in which it occurs.

Inventories

Inventories are stated at the lower of cost (first-in, first-out method) and market.

Revenue Recognition

Revenues from real estate investment transactions are recognized on an accrual basis based on the internal rate of return realized for each loan, which takes into account the current and deferred interest and fees.

Revenues from real estate transactions are recognized as follows:

- Condominium sales: when the amount due on occupancy is received and the purchaser is entitled to occupancy and undertakes to assume a mortgage for the balance of the purchase price.
- Land sales: when all material conditions precedent to closing have been fulfilled, at least 25% of the purchase price has been received and interest will accumulate at a reasonable rate on the balance which is not subordinated to additional loans on the property.

The Company does not have any continuing involvement with properties sold that would result in retention of any substantial risks or rewards of ownership.

Capital Assets

Capital assets are recorded at cost. Depreciation is provided on a straight-line basis over the estimated useful lives:

Furniture, Machinery and Equipment	five to eight years
Buildings	twenty-five to forty years
Leasehold Improvements	over the term of the specific leases

Notes to Consolidated Financial Statements

(Tabular amounts expressed in Canadian thousands of dollars, except per common share amounts)

Goodwill

Goodwill, the excess of the cost of business acquisitions over the fair value of the underlying assets acquired, is capitalized and amortized on a straight-line basis over thirty years. The Company periodically reviews the carrying value of its goodwill to determine whether an impairment in such goodwill has occurred.

Deferred Income Taxes

The Company follows the deferral method of tax allocation under which income taxes are provided for in the period during which transactions are included in accounting income. Under this method, where potential tax benefits of losses are not recognized in the year incurred due to lack of virtual certainty as to realization, they subsequently are recognized only as realized.

Accounting Change

In 1998, the Company has retroactively adopted the recommendations set forth in CICA Handbook Section 1540 - Statement of Cash Flows. See note 18(c) for the impact on the current year's financial statements. Financial statements of the prior years have been restated to exclude restricted cash from cash and short-term investments.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates such as provision for losses on real estate investments, and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. Actual results could differ from those estimates.

Cash and Cash Equivalents

The Company considers all highly liquid investments purchased with a maturity of 90 days or less to be cash equivalents. Cash equivalent balances could include bank term deposits, guaranteed investment certificates, or investment grade commercial paper.

2. CHANGE IN REPORTING CURRENCY

Effective August 1, 1997, the Company adopted the Canadian dollar as its reporting currency. The sale of Hayden Industrial Products LLC during the year marked the end of the Company's industrial and automotive operations, which were based primarily in the United States. The Company's continuing real estate investment operations are based in Canada and substantially all transactions are denominated in Canadian dollars. The consolidated financial statements presented for comparative purposes have been translated into Canadian dollars using a convenience method of translation by which amounts previously stated in U.S. dollars have been translated into Canadian dollars at the July 31, 1997 exchange rate of \$1.3783. As described in note 15, this method differs from the method required for U.S. GAAP reporting.

3. ACQUISITIONS AND DIVESTITURES

(a) Sale of Hayden Industrial Products LLC

On April 30, 1998, the Company completed the sale of its last automotive and industrial division. Hayden Industrial Products LLC was sold to the Company's principal shareholder group for \$7.4 million

Notes to Consolidated Financial Statements

(Tabular amounts expressed in Canadian thousands of dollars, except per common share amounts)

(U.S.). The transaction was approved by a majority of the minority shareholders of the Company at the Annual and Special meeting held on March 26, 1998. The results from this business have been accounted for as discontinued operations and previously reported financial statements have been restated accordingly.

	Year ended July 31		
	1998	1997	1996
Revenues from discontinued operations	\$ 16,067	\$ 19,018	\$ 71,557
Loss from discontinued operations before income taxes	\$ (1,159)	\$ (124)	\$ (4,244)
Loss on disposal of obsolete equipment	(293)	-	-
Income taxes	(226)	-	-
Loss from discontinued operations	(1,678)	(124)	(4,244)
Gain on disposal of Hayden Industrial Products	2,086	-	-
Gain (loss) on disposal of other businesses	(384)	(1,267)	5,167
Gain (loss) on disposal of assets before income taxes	1,702	(1,267)	5,167
Income taxes	(426)	(59)	(804)
Gain (loss) on disposal of assets	1,276	(1,326)	4,363
Minority interest	-	-	(1,227)
Total	\$ (402)	\$ (1,450)	\$ (1,108)

The total assets and liabilities from discontinued operations at July 31, 1997 were \$13,368,000 and \$4,211,000 respectively (July 31, 1996 - \$28,521,000 and \$9,702,000).

(b) Acquisition of the Toronto Film Studio

On January 7, 1998, the Company acquired the Toronto Film Studio for \$5.0 million, comprising \$2.0 million cash and a \$3.0 million promissory note payable.

(c) Sale of the Aftermarket Cooling Business (the "A/M Sales")

In August 1996, the Company completed the first of a two-stage sale of its aftermarket cooling business. The second stage closed in December 1996. A \$1.3 million pre-tax loss was recorded.

(d) Sale of certain Automotive and Industrial Divisions

During fiscal 1996, certain of the Company's automotive and industrial divisions were sold. In total, \$35.3 million of proceeds were received and a \$5.2 million pre-tax gain was recorded.

(e) Automotive and Industrial

During fiscal 1996, the Company acquired all of the common shares previously held by the minority shareholders in the automotive and industrial business. The total consideration paid for the minority shareholders' 30% interest was \$17.6 million.

Notes to Consolidated Financial Statements

(Tabular amounts expressed in Canadian thousands of dollars, except per common share amounts)

4. LOANS RECEIVABLE

At July 31, 1998, there were nine loans receivable relating to the Company's real estate investment business. The loans range in amounts between \$0.3 million and \$3.7 million. The loans earn fees and interest and are anticipated to yield an average annual rate of return of approximately 30%. Security for the loans include specific real estate, personal guarantees and general security agreements.

	July 31	
	1998	1997
Loans receivable	\$ 15,602	\$ 7,416
Allowance for bad debts	410	-
	\$ 15,192	\$ 7,416

Each loan is reviewed regularly to determine whether there has been an impairment in the principal or interest and fees receivable. Any impairment is recorded in the period it is identified. In addition, the Company applies a general reserve against revenues recognized.

The loan repayments are as follows:

Years ending July 31	
1999	\$ 10,661
2000	3,440
2001 and thereafter	1,091
	\$ 15,192

5. CONCENTRATION OF CREDIT RISK

Financial instruments which potentially subject the Company to concentration of credit risk consist principally of loans receivable. The loans receivable are primarily to companies in the real estate development market. The ability of the debtors to meet contractual obligations would be similarly affected by changing economic, political, or other conditions. In order to reduce risks, the Company has credit procedures in place, performs due diligence, reviews economic conditions, and analyzes related financial information on an ongoing basis.

6. AMOUNTS RECEIVABLE

	July 31	
	1998	1997
Note receivable	\$ -	\$ 3,279
Income taxes receivable	-	550
Other	176	-
	\$ 176	\$ 3,829

Notes to Consolidated Financial Statements

(Tabular amounts expressed in Canadian thousands of dollars, except per common share amounts)

7. INVENTORIES

	July 31	
	1998	1997
<i>Automotive and industrial</i>		
Raw materials	\$ -	\$ 1,008
Work in process	-	484
Finished goods	-	260
	-	1,752
Obsolescence reserve	-	(73)
	\$ -	\$ 1,679

8. RELATED PARTY TRANSACTIONS

(a) The Company borrowed \$3.0 million from a company, the controlling shareholder of which is a party related to the Company's Chairman. Also, the Company borrowed \$1.6 million from another company in which the Company's principal shareholder group has an investment. The loans were repaid during the year. Interest and commitment fees incurred on these loans during the year were \$115,000 (nil - 1997).

(b) During 1996, the Company repaid approximately \$0.2 million of promissory notes payable to a company indirectly controlled by a trust for the children of the Company's Chairman and approximately \$1.2 million of promissory notes payable to a former director of the Company.

(c) Substantially all of the Company's preferred shares were held by companies which are subsidiaries of a company controlled by a trust for the children of the Company's Chairman. The balance of the preferred shares were held by a company over which control or direction may be exercised by the Company's President. All of the preferred shares were redeemed during fiscal 1996.

(d)

	Year ended July 31		
	1998	1997	1996
Fees paid for management and other services provided by a company controlled by a trust for the children of the Company's Chairman	\$ 1,238	\$ 1,225	\$ 1,660

(e) The Company leases approximately 17,500 square feet of office space in Don Mills, Ontario from a corporation controlled by a person related to the Company's Chairman, for \$223,000 annually. The lease expires in 2002. The Company subleases part of the office space to a company controlled by a trust for the children of the Company's Chairman for \$86,000 annually, and to another company in which the Company's principal shareholder group has an investment for \$52,000 annually.

(f) Advances to or from related parties primarily represents the excess of the Company's advances to joint ventures over and above the proportionate share of net assets.

Notes to Consolidated Financial Statements

(Tabular amounts expressed in Canadian thousands of dollars, except per common share amounts)

9. CAPITAL ASSETS

	Cost		Accumulated depreciation and amortization		Net Book Value	
	July 31		July 31		July 31	
	1998	1997	1998	1997	1998	1997
Furniture, equipment, and leasehold improvements	\$ 147	\$ 538	\$ 120	\$ 531	\$ 27	\$ 7
Automotive and industrial machinery and equipment	-	3,487	-	938	-	2,549
Income producing assets						
Land	6,995	1,630	1,535	1,535	5,460	95
Buildings	22,791	3,945	2,914	2,507	19,877	1,438
Furniture, equipment and other	2,447	1,636	186	1,538	2,261	98
	\$ 32,380	\$ 11,236	\$ 4,755	\$ 7,049	\$ 27,625	\$ 4,187

Accumulated depreciation and amortization includes a \$2.5 million provision, recorded in 1992, for decline in value of the Best Western Hidden Valley Resort Hotel assets which form part of the income producing assets. Income producing assets include \$130,000 of interest capitalized during the year (nil - 1997).

10. MORTGAGES AND LOAN PAYABLE

	July 31	
	1998	1997
Mortgages payable (a)	\$ 14,306	\$ -
Loan payable (b)	2,000	-
	\$ 16,306	\$ -

Weighted average annual interest rates 8.1%

(a) The mortgages payable have varying interest rates currently ranging from 5% to 9.5% and are secured by the properties to which they relate.

(b) On May 15, 1998, the Company entered into a credit agreement with Union Bank of Switzerland ("UBS") for a \$20 million secured term loan facility. This facility, which has been assigned by UBS to Fortress Investment Corp., has an initial term of one year expiring July 20, 1999, and may be extended, at the Company's option, for up to one additional year. The loan bears interest at a varying cost of between UBS Bankers' Acceptance Rate plus 3.5% to 4.5% per annum. As at July 31, 1998, the rate on the loan was 8.6% per annum. The Company is obliged to repay the loan out of proceeds of certain loan repayments and asset dispositions. The Company has assigned its loans receivable, equity interests, and capital assets as security for the facility. As at October 15, 1998, the Company had drawn \$10 million pursuant to this facility.

Notes to Consolidated Financial Statements

(Tabular amounts expressed in Canadian thousands of dollars, except per common share amounts)

(c) The principal repayments are as follows:

Years ending July 31,	Mortgages	Loan	Total
1999	\$ 3,388	\$ 2,000	\$ 5,388
2000	4,061	—	4,061
2001	3,270	—	3,270
2002	54	—	54
2003	1,621	—	1,621
2004 and thereafter	1,912	—	1,912
	\$ 14,306	\$ 2,000	\$ 16,306

11. SHAREHOLDERS' EQUITY

(a) Changes in the Company's outstanding common share capital were as follows:

	Number of Shares		Amount	
	July 31		July 31	
	1998	1997	1998	1997
Balance - beginning of year	22,875,900	22,967,907	\$ 33,043	\$ 33,168
Shares repurchased	(12,100)	(92,000)	(16)	(125)
Fractional shares eliminated				
pursuant to a prior acquisition	(4)	(7)	—	—
Balance - end of year	22,863,796	22,875,900	\$ 33,027	\$ 33,043

The aggregate legal stated capital of the common shares of the Company is \$16.8 million.

(b) The following stock option plan was in effect in 1998:

1985 Stock Option Plan -

Options have been granted to certain employees, officers and directors under this Plan. 50,000 of the options held by employees and officers are fully vested and expire by March 2000, with the balance vesting in equal annual increments over four years and expiring proportionately on the fourth anniversary of each vesting date, in each case subject to earlier expiry upon termination of employment and certain other events. 45,000 options have been granted to directors. These options vest at the next annual meeting of shareholders of the Company and expire on the fourth anniversary thereafter, subject to earlier expiry upon resignation or removal from the Board. Total options under the Plan are limited to 2,286,380. During 1998, 174,500 options were granted at \$2.10 and 30,000 options expired, leaving 224,500 options outstanding. 75,900 options are fully exercisable and 148,600 will vest over the next four years. The price ranges from \$1.80 to \$2.60.

Notes to Consolidated Financial Statements

(Tabular amounts expressed in Canadian thousands of dollars, except per common share amounts)

12. INCOME TAX INFORMATION

(a) Income Taxes

	Year ended July 31		
	1998	1997	1996
Combined Canadian federal and provincial income tax rate	44.6%	44.6%	44.3%
Earnings (loss) from operations	\$ 1,463	\$ 222	\$ (4,607)
Losses not tax effected	368	—	4,607
	\$ 1,831	\$ 222	\$ —
Tax at basic rates	\$ 817	\$ 99	\$ —
Decrease in taxes resulting from:			
Realization of benefits of loss carryforwards	(817)	(99)	—
	—	—	—
Federal capital tax	46	29	19
Income taxes	\$ 46	\$ 29	\$ 19
Effective tax rate	3.1%	13.1%	(0.4)%

(b) At July 31, 1998, the Company and its subsidiaries had operating loss carryforwards for Canadian tax purposes which expire as follows:

July 31	
1999	\$ 33
2000	—
2001	2,205
2002	1,441
2003	2,084
2004 and after	6,023
	\$ 11,786

The Company has inactive U.S. subsidiaries with operating loss carryforwards of approximately \$1.5 million expiring after 2004. The tax value of certain capital assets exceeds the carrying value by approximately \$2.1 million. The future tax benefits of these losses and temporary differences have not been recognized for financial reporting purposes. Deferred income taxes of \$413,000 recognized at July 31, 1997 related to excess tax basis over book basis of certain assets and goodwill of discontinued operations.

Notes to Consolidated Financial Statements

(Tabular amounts expressed in Canadian thousands of dollars, except per common share amounts)

13. NET EARNINGS (LOSS) PER COMMON SHARE

The weighted average number of outstanding shares which was used to calculate net earnings (loss) per common shares was derived as follows:

	Year ended July 31		
	1998	1997	1996
Common shares outstanding, beginning of year	22,875,900	22,967,907	23,445,846
Weighted average shares redeemed	(10,977)	(17,800)	(82,275)
Average shares outstanding - basic and fully diluted	22,864,923	22,950,107	23,363,571

The effect of options outstanding as at July 31, 1998, 1997, and 1996 has no impact on the reported per share amounts.

14. INVESTMENTS IN AND LOANS TO LIMITED PARTNERSHIPS AND JOINT VENTURES

Investments in and loans to limited partnerships include two loans bearing varying interest rates of 20% - 24% per annum and are expected to be repaid before July 31, 2000. Interest earned on these loans is recognized based on the percentage owned by other partners.

(a) Limited Partnerships

	Partnership interest
Keele St. Clair Limited Partnership	50%
800 King Street West Limited Partnership	50%

The Partnerships had no revenues or expenses during the year. The proportionate share of the assets and liabilities are as follows:

Assets	\$ 6,491
Liabilities	3,097

Included in the assets is \$124,000 of interest which has been capitalized.

(b) Joint Ventures

The proportionate share of, or undivided interest in the assets, liabilities, revenues and expenses is reflected in the consolidated financial statements as follows:

	Ownership interest
Whitby Joint Venture	75%
Rospin Joint Venture	50%

	Year ended July 31		
	1998	1997	1996
Assets	\$ 2,187	\$ 1	\$ 7,028
Liabilities	1,580	1	2,944
Revenues	60	5,848	-
Cost of sales	-	5,042	-
Expenses	52	386	-
Provision for diminution	-	-	4,362

The year ended July 31, 1998 reflects primarily the results from the Rospin Joint Venture, and the prior years relate mostly to the Whitby Joint Venture, the assets of which were sold in 1997. The 1996 provision for diminution related to a write-down of land inventory in the Whitby Joint Venture.

Notes to Consolidated Financial Statements

(Tabular amounts expressed in Canadian thousands of dollars, except per common share amounts)

15. SIGNIFICANT DIFFERENCES BETWEEN CANADIAN AND UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("Canadian Basis") which differ in certain respects from those prepared in accordance with accounting principles and practices generally accepted in the United States ("U.S. Basis"). Under the U.S. Basis certain items in the Consolidated Statement of Earnings and the Consolidated Balance Sheet would have been reported as follows:

(a) Consolidated Statement of Earnings

	Year ended July 31		
	1998	1997	1996
Earnings (loss) from continuing operations			
- Canadian Basis	\$ 1,546	\$ 193	\$ (4,626)
Decreased tax provision - deferred (i)	2,342	-	-
Add back dividends paid on preferred shares (iii)	-	-	568
Adjustment for convenience translation method (ii)	-	(2)	55
Earnings (loss) from continuing operations	3,888	191	(4,003)
Loss from discontinued operations			
- Canadian Basis	(402)	(1,450)	(1,108)
Increased depreciation and amortization (i) (iv)	-	(62)	(212)
Decreased gain on disposal of assets (i) (ii) (iv)	-	(521)	(1,416)
Increased tax provision - deferred (i) (iv)	(271)	(281)	(586)
Adjustment for convenience translation method (ii)	171	19	39
Loss from discontinued operations	(502)	(2,295)	(3,283)
Net earnings (loss)	\$ 3,386	\$ (2,104)	\$ (7,286)
- U.S. Basis			
Per common share:			
Continuing operations	\$ 0.17	\$ 0.01	\$ (0.17)
Discontinued operations	\$ (0.02)	\$ (0.10)	\$ (0.14)
Total	\$ 0.15	\$ (0.09)	\$ (0.31)

Consolidated Balance Sheet

	July 31, 1998		July 31, 1997	
	Canadian Basis	U.S. Basis	Canadian Basis	U.S. Basis
Assets				
Deferred income taxes - asset	\$ -	\$ 2,342	\$ 413	\$ 684
Liabilities and Shareholders' Equity				
Retained earnings	\$ 2,446	\$ 4,591	\$ 1,300	\$ 1,203
Currency translation adjustment	(100)	97	(61)	307
	\$ 2,346	\$ 4,688	\$ 1,239	\$ 1,510

Notes to Consolidated Financial Statements

(Tabular amounts expressed in Canadian thousands of dollars, except per common share amounts)

(i) Under the Canadian Basis the tax benefits of certain operating loss carryforwards were not recognized in the year the losses were incurred because the realization of the benefits was not virtually certain. Further, certain operating loss carryforwards of an acquired U.S. company were not recognized as an asset at the date of acquisition because the realization of the benefits was not reasonably assured. The tax benefits of these operating loss carryforwards are recognized as a reduction of income tax expense only when they are realized. Under the U.S. Basis, as set forth in the Statement of Financial Accounting Standards ("FAS") No. 109, the tax benefits of these loss carryforwards may be recognized in a subsequent year when change in circumstances justifies a decrease in the related valuation allowance. For the operating loss carryforwards of the acquired company, the benefits subsequently recognized were first applied to reduce to zero the goodwill related to the acquisition, next applied to reduce to zero intangible assets related to the acquisition, and finally applied to reduce income tax expense. As at July 31, 1998 and 1997, management has recognized deferred tax assets for U.S. Basis purposes on the basis that estimates of taxable income for the succeeding two years and reversing taxable temporary differences indicated that realization of the assets was more likely than not.

(ii) Under the U.S. Basis, the use of the convenience method to effect a change in reporting currency (as described in note 2) is not acceptable. The U.S. Basis results have been determined by recasting prior years' financial statements as if the Canadian dollar had been used since August 1, 1995.

(iii) Under the U.S. Basis, dividends paid on the preferred shares would not be included in the determination of net earnings.

(iv) Under the Canadian Basis, the fair values of the net assets acquired in business combinations are adjusted for differences from the amounts used for tax purposes, whereas under the U.S. Basis, deferred income taxes are recorded on such differences.

(b) Earnings Per Share

The Company has adopted the provisions of FAS 128 for reporting earnings per share under the U.S. Basis. No retroactive restatement of prior years' U.S. Basis basic and fully diluted earnings per share was necessary, because the stock options outstanding during the years ended July 31, 1998, 1997 and 1996 were antidilutive and thus excluded from the determination of earnings per share under the old U.S. Basis under Accounting Principles Board Opinion No. 15, "Earnings Per Share".

Under both the U.S. Basis and the Canadian Basis, basic earnings per share are computed by dividing the net income (loss) for the period available to common shareholders, as measured by the respective accounting principles, by the weighted average number of common shares outstanding during that period. Basic earnings per share exclude the dilutive effect of potential common shares.

Fully diluted earnings per share under Canadian Basis and diluted earnings per share under U.S. Basis give effect to all potential common shares outstanding during the period. Under Canadian Basis, fully diluted earnings per share are calculated assuming that the proceeds from the exercise of stock options are invested at an appropriate rate of return, and an imputed interest amount is added to net income for the period. The number of fully diluted shares outstanding represents the weighted average maximum number of potential common shares outstanding. Under U.S. Basis, the weighted average number of diluted shares outstanding is calculated assuming that the proceeds from stock options are used to repurchase common shares at the average share price in the period. No adjustment is made to net income for imputed interest in calculating diluted earnings per share under U.S. Basis.

Notes to Consolidated Financial Statements

(Tabular amounts expressed in Canadian thousands of dollars, except per common share amounts)

For the years ended July 31, 1998, 1997, and 1996, the impact of stock options are antidilutive and are excluded from the calculation of diluted net earnings (loss) per share. Accordingly, diluted net earnings (loss) per share are equivalent to basic net earnings (loss) per share.

(c) Joint Ventures

Under the U. S. Basis, joint ventures would be accounted for on an equity or consolidated basis, as appropriate. The use of these methods would not result in any differences to net earnings or shareholders' equity.

(d) Statement of Cash Flows

As described in note 1, the Company has restated prior years' statements of cash flow to adopt the new recommendations contained in CICA Handbook Section 1540. As a result of this accounting change, the differences reported in prior years concerning the presentation of certain non-cash investing and financing activities have been eliminated.

(e) Accounting for Stock Options

Under the Canadian Basis, there is no requirement to record deferred compensation liability or expense upon the grant of compensatory stock options. Under the U.S. Basis, the Company measures the compensation cost for stock option awards to employees using the intrinsic value based method prescribed by Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees". No material differences have arisen to date as a result of these policies. Had compensation cost been determined under the U.S. Basis using the provisions of FAS 123, "Accounting for Stock-Based Compensation", which utilizes a fair value based method, the Company's net earnings for 1998 would have been decreased by approximately \$21,000, with no impact on reported U.S. Basis earnings per share. No options subject to FAS 123 were outstanding during the 1997 and 1996 fiscal years. The Company's calculations for the year ended July 31, 1998 were made using the Black-Scholes option pricing model with the following assumptions:

Dividend yield	0%
Risk-free interest rates	5%
Volatility	85%
Expected life of options in years	4

The weighted average fair value of options granted during the year was \$1.35 per share.

(f) Valuation of Long-Lived Assets

In 1997, the Company adopted FAS 121 "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of". The application of FAS 121 has had no impact on the Company's financial position and results of operations for the three years ended July 31, 1998. However, for U.S. Basis reporting, the Company is required to periodically evaluate the carrying value of its long-lived assets to be held and used, consisting primarily of its capital assets, when events and circumstances warrant such a review. The carrying value of a capital asset is considered impaired when the anticipated cash flow from such asset (undiscounted and without interest) is separately identifiable and less than its carrying value. In that event, a loss is recognized based on the amount by which the carrying value exceeds the fair value of the capital asset, estimated by discounting the expected future cash flows at a rate commensurate with the risks involved.

Notes to Consolidated Financial Statements

(Tabular amounts expressed in Canadian thousands of dollars, except per common share amounts)

(g) New Accounting Standards Not Yet Adopted

SFAS 130, "Reporting Comprehensive Income", establishes standards for reporting and display of comprehensive income (which is all changes in the net equity of a business due to transactions or other events not involving owners) and its components (revenues, expenses, gains and losses). While it does not specify a format of presentation, SFAS 130 does require that all items that are required to be recognized as components of comprehensive income be reported in a financial statement that is displayed with the same prominence as other financial statements. SFAS 130, which does not address issues of recognition or measurement of comprehensive income, is effective for fiscal years beginning after December 15, 1997.

SFAS 131, "Disclosures about Segments of an Enterprise and Related Information", establishes new standards for the reporting of information about the operating segments of a business. It also establishes standards for related disclosures about products and services, geographic areas and major customers. Generally, SFAS 131 requires that the definition of operating segments reflect the manner in which the enterprise's chief operating decision maker decides how to allocate resources and assess performance. SFAS 131 is effective for fiscal years beginning after December 15, 1997.

Management does not believe that the adoption of these new accounting standards will materially affect its historical results of operations or shareholders equity.

16. OTHER INFORMATION

(a) Cash and Short-term Investments

The cash and short-term investments include \$539,000 (\$1,647,000 - July 31, 1997) of U.S. dollars.

(b) Restricted Cash

Restricted cash consists of cash and/or short-term investments which are being held to secure outstanding letters of credit in connection with prior real estate development operations, and to provide security for a mortgage on one of the income producing assets.

Notes to Consolidated Financial Statements

(Tabular amounts expressed in Canadian thousands of dollars, except per common share amounts)

17. SEGMENTED INFORMATION

The following summarizes the Company's operations by industry segment:

	Real Estate Investment			
	Financing and Development	Income Producing	Corporate and Other	Total
July 31, 1998				
Revenues	\$ 3,363	\$ 5,799	\$ 420	\$ 9,582
Cost of sales and expenses	463	5,084	2,572	8,119
Earnings (loss) from operations	\$ 2,900	\$ 715	\$ (2,152)	\$ 1,463
Total assets	\$ 23,076	\$ 29,330	\$ 3,976	\$ 56,382
Depreciation and amortization	\$ -	\$ 521	\$ 6	\$ 527
July 31, 1997				
Revenues	\$ 6,444	\$ 2,787	\$ 1,152	\$ 10,383
Cost of sales and expenses	6,403	2,251	1,507	10,161
Earnings (loss) from operations	\$ 41	\$ 536	\$ (355)	\$ 222
Total assets	\$ 8,182	\$ 2,102	\$ 16,083	\$ 26,367
Depreciation and amortization	\$ -	\$ 222	\$ 5	\$ 227
July 31, 1996				
Revenues	\$ 2,405	\$ 2,609	\$ 1,749	\$ 6,763
Cost of sales and expenses	6,641	2,378	2,351	11,370
Earnings (loss) from operations	\$ (4,236)	\$ 231	\$ (602)	\$ (4,607)
Total assets	\$ 5,618	\$ 2,187	\$ 13,415	\$ 21,220
Depreciation and amortization	\$ -	\$ 215	\$ 102	\$ 317

The total assets for the years ended July 31, 1997 and 1996 exclude the assets of discontinued operations as disclosed in note 3.

Notes to Consolidated Financial Statements

(Tabular amounts expressed in Canadian thousands of dollars, except per common share amounts)

18. ADDITIONAL INFORMATION

(a) Details of net changes in non-cash operating balances as reported in the Consolidated Statement of Cash Flows are as follows:

	Year ended July 31		
	1998	1997	1996
Trade receivables	\$ (223)	\$ 28	\$ 102
Amounts receivable	-	598	73
Inventory	-	2,760	1,395
Deposits	(1,228)	-	-
Advances to and from related companies	(646)	1,509	(243)
Accounts payable and accrued liabilities	1,127	47	(340)
Customer deposits	397	-	-
Prepaid expenses and other assets	(1,082)	(363)	(3)
Minority interest	148	-	-
Other liabilities	-	(3)	-
	\$ (1,507)	\$ 4,576	\$ 984

(b) Cash paid for income taxes and for interest (net of amount capitalized) is as follows:

	Year ended July 31		
	1998	1997	1996
Income taxes	\$ 46	\$ 29	\$ 19
Interest (net of amount capitalized)	\$ 355	\$ 258	\$ 319

(c) Non cash investing and financing activities

In conjunction with the purchase of capital assets, the Company assumed approximately \$12.0 million of mortgages payable.

19. COMMITMENTS AND CONTINGENCIES

(a) Minimum annual payments under the following commitments are:

Years ending July 31,	Management		Total
	Leased Premises	and Other Services	
1999	\$ 223	\$ -	\$ 223
2000	223	-	223
2001	223	-	223
2002	223	-	223
2003	37	-	37
	\$ 929	\$ -	\$ 929

Under the leases, the Company is responsible for taxes, insurance, and maintenance, no portion of which is set out in this note, and sub-leases part of its office space to one party for \$86,000 annually, and another party for \$52,000 annually (note 8(e)). The fees commitment for management and other services is currently under review by the Compensation Committee and other non-management directors of the Company and, when approved, will be effective as of August 1, 1998.

Notes to Consolidated Financial Statements

(Tabular amounts expressed in Canadian thousands of dollars, except per common share amounts)

(b) Letters of credit have been issued with respect to two completed development sites totalling \$0.7 million at July 31, 1998 (\$0.7 million - 1997).

(c) The Company has guaranteed a first mortgage loan for \$0.5 million with respect to one of its structured financing loans.

(d) One of the Company's subsidiaries is a defendant, along with others, in a lawsuit alleging damages and deficiencies arising out of construction of the Symphony Place condominium tower. The Company believes that the claim is unlikely to succeed. In any event, the exposure is likely limited to defence costs.

(e) The Company has identified certain environmental matters relating to soil contamination and waste water treatment systems at certain of its former U.S. manufacturing facilities for which the Company is responsible. The Company incurred \$191,000 (\$95,000 - 1997; \$364,000 - 1996) of remediation costs during the year. The balance of the liability accrued at July 31, 1998 is \$298,000.

A final assessment has been prepared by independent consultants and remediation is underway.

(f) The Company has committed to fund an additional \$3.5 million in respect of the \$15.2 million of loans receivable as at July 31, 1998. In addition, \$5.0 million of new loans have been committed subsequent to year end. As at July 31, 1998, through its joint venture (note 14(b)), the Company had acquired a 25% interest in a rental property in downtown Toronto, and had committed to acquire another 25%. The Company had also committed to acquire an additional self storage site. Since year end, the Company has agreed to acquire a 50% interest in another self storage site and a commercial rental building. The Company's share of the purchase price for these additional commitments will be \$4.3 million.

20. FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

The carrying values of cash and short-term investments, trade receivables, accounts payable and accrued liabilities approximate their fair value due to the relatively short periods to maturity of the instruments.

The estimated fair values of loans receivable were estimated based on discounted cash flow and credit risk analysis using lending rates in the structured financing market which have not changed significantly since the inception of the loans. The fair values approximate the carrying values of these loans as at July 31, 1998 and 1997.

The estimated fair values of mortgages and loans payable were estimated based on discounted cash flow. The fair market value approximates the carrying values of the loans.

21. UNCERTAINTY DUE TO THE YEAR 2000 ISSUE

The Year 2000 issue arises because many computerized systems use two digits rather than four to identify a year. Date sensitive systems may recognize the year 2000 as 1900 or some other date, resulting in errors when some information using year 2000 dates is processed. In addition, similar problems may arise in some systems which use certain dates in 1999 to represent something other than a date. The effects of the Year 2000 issue may be experienced before, on, or after January 1, 2000 and, if not addressed, the impact on operations and financial reporting may range from minor errors to significant systems failure which could affect an entity's ability to conduct normal business operations. It is not possible to be certain that all aspects of the Year 2000 issue affecting the entity, including those related to the efforts of customers, suppliers or other third parties, will be fully resolved.

22. COMPARATIVE FIGURES

Certain prior years' accounts have been reclassified to conform with the current year's presentation.

Selected Financial Data

(Expressed in Canadian thousands of dollars, except per common share amounts)

	Year ended July 31		
	1998	1997	1996
Revenues	\$ 9,582	\$ 10,383	\$ 6,763
Cost of sales and expenses	8,119	10,161	7,008
Provision for diminution in asset values	—	—	4,362
Earnings (loss) from operations	1,463	222	(4,607)
Share of income (loss) from investments	—	—	—
Earnings (loss) before income taxes and minority interest	1,463	222	(4,607)
Income taxes - current	46	29	19
- deferred	—	—	—
Net earnings (loss) from operations before minority interest	1,417	193	(4,626)
Minority interest in losses of subsidiaries	(129)	—	—
Earnings (loss) from continuing operations	1,546	193	(4,626)
Gain (loss) discontinued operations	(402)	(1,450)	(1,108)
Net earnings (loss)	\$ 1,144	\$ (1,257)	\$ (5,734)
Net earnings (loss) per common share			
Continuing operations	\$ 0.07	\$ 0.01	\$ (0.20)
Discontinued operations	\$ (0.02)	\$ (0.06)	\$ (0.05)
Total assets	\$ 56,382	\$ 39,735	\$ 49,741
Long-term debt, including current portion	\$ 16,306	\$ —	\$ 3,199
Redeemable preferred shares	\$ —	\$ —	\$ —

See note 3 to the Company's audited consolidated financial statements included herein for a description of certain acquisitions and divestitures made by the Company during the last three fiscal years.

See note 15 for a reconciliation of net earnings and total assets to U.S. generally accepted accounting principles for the last three fiscal years.

		7 Months ended July 31		Year ended December 31				
1995	1994	1993	1992	1991	1990	1989	1988	
\$ 3,214	\$ 3,563	\$ 3,490	\$ 40,937	\$ 24,430	\$ 81,510	\$ 51,022	\$ 31,043	
5,207	5,163	4,718	37,575	24,323	74,312	37,723	24,921	
280	1,382	1,143	7,592	2,745	17,579	434	-	
(2,273)	(2,982)	(2,371)	(4,230)	(2,638)	(10,381)	12,865	6,122	
-	(130)	-	(487)	(1,646)	(974)	(893)	127	
(2,273)	(3,112)	(2,371)	(4,717)	(4,284)	(11,355)	11,972	6,249	
85	21	(74)	65	266	(5,921)	4,591	1,698	
(30)	-	-	(1,990)	(2,094)	1,150	1,464	1,014	
(2,328)	(3,133)	(2,297)	(2,792)	(2,456)	(6,584)	5,917	3,537	
-	-	-	-	-	-	-	-	
(2,328)	(3,133)	(2,297)	(2,792)	(2,456)	(6,584)	5,917	3,537	
14,599	3,899	1,359	-	-	-	-	-	
\$ 12,271	\$ 766	\$ (938)	\$ (2,792)	\$ (2,456)	\$ (6,584)	\$ 5,917	\$ 3,537	
\$ (0.10)	\$ (0.13)	\$ (0.12)	\$ (0.17)	\$ (0.18)	\$ (0.61)	\$ 0.54	\$ 0.33	
\$ 0.62	\$ 0.17	\$ 0.07	-	-	-	-	-	
\$ 100,078	\$ 129,057	\$ 124,411	\$ 48,755	\$ 67,654	\$ 95,297	\$ 118,294	\$ 70,602	
\$ 9,655	\$ 47,535	\$ 48,370	\$ 16,034	\$ 32,684	\$ 56,458	\$ 50,759	\$ 28,884	
\$ 6,748	\$ 6,748	\$ 6,748	\$ 4,686	\$ 4,686	\$ 2,970	\$ 2,970	\$ 2,970	

Supplementary Data – Quarterly Financial Information

(Unaudited) (Expressed in Canadian thousands of dollars, except per common share amounts)

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year
1998					
Revenue from income producing properties	\$ 1,050	\$ 643	\$ 1,491	\$ 2,615	\$ 5,799
Interest and fee income	666	690	857	1,228	3,441
Interest from limited partnership	26	70	120	126	342
Property sales	–	–	–	–	–
Total revenues	\$ 1,742	\$ 1,403	\$ 2,468	\$ 3,969	\$ 9,582
Earnings from operations	\$ 778	\$ 161	\$ 104	\$ 420	\$ 1,463
Net earnings from continuing operations	\$ 773	\$ 164	\$ 174	\$ 435	\$ 1,546
Gain (loss) from discontinued operations	\$ 83	\$ (761)	\$ 514	\$ (238)	\$ (402)
Net earnings (loss)	\$ 856	\$ (597)	\$ 688	\$ 197	\$ 1,144
Net earnings (loss) per common share					
Continuing operations	\$ 0.03	\$ 0.01	\$ 0.01	\$ 0.02	\$ 0.07
Discontinued operations	\$ 0.00	\$ (0.03)	\$ 0.02	\$ (0.01)	\$ (0.02)
1997					
Revenue from income producing properties	\$ 1,014	\$ 398	\$ 545	\$ 829	\$ 2,786
Interest and fee income	284	302	310	591	1,487
Interest from limited partnership	–	–	–	–	–
Property sales	262	–	–	5,848	6,110
Total revenues	\$ 1,560	\$ 700	\$ 855	\$ 7,268	\$ 10,383
Earnings (loss) from operations	\$ 117	\$ (276)	\$ (98)	\$ 479	\$ 222
Net earnings (loss) from continuing operations	\$ 112	\$ (292)	\$ (101)	\$ 474	\$ 193
Loss from discontinued operations	\$ (59)	\$ (593)	\$ (40)	\$ (758)	\$ (1,450)
Net earnings (loss)	\$ 53	\$ (885)	\$ (141)	\$ (284)	\$ (1,257)
Net earnings (loss) per common share					
Continuing operations	\$ 0.00	\$ (0.01)	\$ 0.00	\$ 0.02	\$ 0.01
Discontinued operations	\$ 0.00	\$ (0.03)	\$ 0.00	\$ (0.03)	\$ (0.06)

Market for the Registrant's Common Shares

Related Security Holder Matters

The Company's Common Shares were offered to the public on April 23, 1981, and thereafter, have been traded on The Nasdaq Stock MarketSM ("Nasdaq") in the United States. The current Nasdaq symbol is TRSEF. On December 17, 1987, the Company's Common Shares were listed for trading on The Toronto Stock Exchange ("TSE") in Canada. The current TSE trading symbol is RSE.

The high and low bid quotations on the TSE reported in Canadian dollars and on Nasdaq reported in United States dollars for each fiscal quarterly period indicated were as follows:

The Toronto Stock Exchange (expressed in Canadian dollars)

	1998		1997		1996	
	High	Low	High	Low	High	Low
1st Quarter	\$ 1.30	\$ 1.15	\$ 1.40	\$ 1.00	\$ 1.55	\$ 1.00
2nd Quarter	1.80	1.23	1.30	0.91	1.40	0.90
3rd Quarter	2.20	1.55	1.16	1.10	1.30	1.00
4th Quarter	1.95	1.60	1.40	1.15	1.30	1.00

NASDAQ (expressed in U.S. dollars)

	1998		1997		1996	
	High	Low	High	Low	High	Low
1st Quarter	\$ 0.92	\$ 0.75	\$ 0.94	\$ 0.69	\$ 1.25	\$ 0.69
2nd Quarter	1.31	0.81	0.81	0.69	1.06	0.68
3rd Quarter	1.69	1.00	0.83	0.75	1.00	0.68
4th Quarter	1.28	1.00	0.94	0.75	0.94	0.68

The Nasdaq quotations reflect inter-dealer prices, without retail mark-up, mark-down, or commission, and may not represent actual transactions.

As of October 6, 1998, there were approximately 1,300 Common shareholders of record. No dividends have been paid on the Common Shares. It is the Company's present policy not to pay cash dividends, but to retain earnings to finance expansion, growth, and investment. Payment of future dividends will be at the discretion of the Board of Directors and will be dependent on the Company's financial condition.

The Investment Canada Act ("ICA") provides that the acquisition of control of a Canadian corporation by a non-Canadian may be subject to review and approval under the ICA, and may be prohibited unless such acquisition is found by the responsible Minister of the Canadian government likely to be of net benefit to Canada.

Dividends paid on Common Shares owned by a non-resident of Canada are subject to Canadian withholding tax under the Income Tax Act (Canada). The general rate of Canadian withholding tax on dividends paid to a non-resident person is 25% of the gross amount of the dividends. This rate may be reduced where there is an applicable tax treaty in existence between Canada and the country of the non-resident dividend recipient.

Under the Canada-U.S. tax treaty, dividends paid by the Corporation to a resident of the United States are generally subject to a Canadian withholding tax of 15% of the gross amount of the dividends.

Corporate Directory

OFFICERS

Sam Reisman
Chairman and
Chief Executive Officer

Stephen R. Morrison
President

Martin Simon
Chief Operating Officer and
Chief Financial Officer

Tim Bankier
Vice President

Ken Ferguson
Vice President

Lana Sherman
Vice President Finance and
Controller

Gary Steinhart
Corporate Secretary

DIRECTORS

Sam Reisman³
Chairman and
Chief Executive Officer
The Rose Corporation

D. Rick Angelson
Barrister and Solicitor
Cassels, Brock & Blackwell

Harold W. Bird²
Executive
Lone Star Opportunity Fund,
L.P.

Peter F. Chodos^{1,2,3}
Financial Services Consultant

Seymour Epstein¹
Chairman
Seyton Ltd., Video Age Ltd.,
and Imagineering Ltd.

Bryan Levman¹
President
Guidelines Advertising Ltd.

Willard J. L'Heureux
Executive
TrizecHahn Corporation

Stephen R. Morrison^{1,3}
President
The Rose Corporation

Elan Pratzer²
Executive
Pratzer & Partners Inc.

1. Indicates member of Audit Committee
2. Indicates member of Compensation Committee
3. Indicates member of Executive Committee

Corporate Information

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M3B 3N2

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Fax: (416) 449-9887
www.rosecorp.com

Legal Counsel:
Cassels, Brock & Blackwell

Auditors:
KPMG LLP

Transfer Agent:
CIBC Mellon Trust Company

Trading Symbols:
TSE: RSE
NASDAQ: TRSEF

Annual Meeting
Shareholders are invited to
attend the Annual Meeting in
Toronto, Ontario, Canada, on
January 21, 1999, at 4:00 p.m.
(Toronto time) at
The Toronto Stock Exchange,
TSE Auditorium.

Form 10-K
Shareholders may obtain,
without charge, a copy of the
Company's Annual Report on
Form 10-K, filed with the
Securities and Exchange
Commission, by contacting:

Corporate Secretary
The Rose Corporation
156 Duncan Mill Road,
Suite 12,
Don Mills, Ontario, Canada
M3B 3N2
Tel: (416) 449-3535
Fax: (416) 449-9887

